

M e m o r a n d u m**150.0386**

To: San Diego – Auditing (CRG)

August 20, 1976

From: Hdqrs - Tax Counsel (GJJ)

Subject: L--- T--- S---

SY -- XX XXXXXX

This is in response to your request of August 12, 1976, that we consider the argument made by Attorney M--- A. S--- in his letter to you of August 10, 1976.

The question at issue is the taxability of a transaction involving L--- T--- S--- (taxpayer) and T--- R--- C---. Taxpayer was the lessee of land and a building located in --- ---, California. Taxpayer operated a bowling alley at the site. Taxpayer purchased the business from H---, Inc., the previous lessee of the site. Taxpayer's purchase included "the liquor license, fixed assets, inventory, bowling lanes, ball return tracks and lifts, the seats, the telescorers, the control desk, the billiard tables, office furniture, typewriters, accounting machines, cash registers, restaurant stoves, refrigerators, vending machines owned by seller, the bar furniture, fixtures and equipment, the glassware, dishes, stock in trade, including resale merchandise, balls, pins, food and liquor stocks, and leasehold interest."

Pursuant to the lease agreement entered into between the owners of the location, L--- H--- S--- Co., Ltd., and taxpayer, taxpayer covenanted that "the fixtures, furniture, and equipment listed" in the preceding paragraph "shall remain on the premises during the entire period covered by the present lease and its extensions, and that as and when any of the fixtures and equipment installed in or upon the demised premises shall become obsolete, lessee shall replace the same...."

Our Regulation 1596 "Buildings and Other Property Affixed to Realty" provides, with respect to fixtures and machinery and equipment affixed to real property, that:

"The transfer 'in place' of affixed fixtures and machinery and equipment, owned by a lessee of land or buildings to which those items are affixed, is also taxable as a sale of personal property when the lessee-seller has the present right to remove the items either as trade fixtures under Section 1019 of the Civil Code or under the express terms of the lease."

Taxpayer has argued that it did not have the “present right to remove the fixtures at the time of their sale since it was obligated to maintain them on the site pursuant to the lease.

The rule for determining whether items sold in place by lessees of real property are taxable is stated in paragraph (c) of Regulation 1596. It is clear that the owner of the real property, L--- H--- S--- Co., Ltd., regarded taxpayer as the owner of the fixtures and equipment. The fact that taxpayer has agreed to keep the property in place during the term of the lease does not negate a conclusion that taxpayer had the present right to remove the items within the meaning of the regulation. The lessor’s “interest” in the property arose not from the law concerning accession to real property (see Civil Code Section 1013, et seq.) but from taxpayer’s contractual undertaking to leave the items in place during the term of the lease. Under the lease agreement taxpayer has undertaken to keep on the premises office furniture, typewriters, accounting machines, cash registers, vending machines, glassware, dishes, balls, pins, and other items in no way affixed to the real property. Clearly the sale of these items was subject to tax despite the undertaking of taxpayer not to remove them from the premises. We think the conclusion should not differ with respect to items which may have been affixed to the realty when the items constituted trade fixtures and were treated by the lessor and the lessee as property belonging to, and alienable by, the lessee.

GJJ:lb